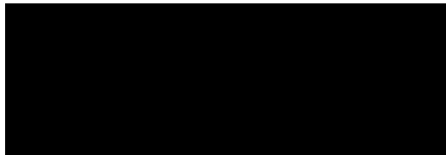


No protest rec'd.  
Closed to [REDACTED] 5/3/93

Internal Revenue Service

District  
Director



Department of the Treasury

P.O. Box 2508  
Cincinnati, OH 45201

Person to Contact:

Telephone Number:

Refer Reply to:

EP/EO

Employer Identification Number:

Date: MAR 23 1993

Dear Sir or Madam:

We have considered your application for recognition of exemption from Federal income tax under the provisions of section 501(c)(3) of the Internal Revenue Code of 1986 and its applicable Income Tax Regulations. Based on the available information, we have determined that you do not qualify for the reasons set forth on Enclosure I.

Consideration was given to whether you qualify for exemption under other subsections of section 501(c) of the Code and we have concluded that you do not.

As your organization has not established exemption from Federal income tax, it will be necessary for you to file an annual income tax return on Form 1041 if you are a trust or Form 1120 if you are a corporation or an unincorporated association. Contributions to you are not deductible under section 170 of the Code.

If you are in agreement with our proposed denial, please sign and return one copy of the enclosed Form 6018, Consent to Proposed Adverse Action.

You have the right to protest this proposed determination if you believe that it is incorrect. To protest, you should submit a written appeal giving the facts, law and other information to support your position as explained in the enclosed Publication 892, "Exempt Organizations Appeal Procedures for Unagreed Issues". The appeal must be submitted within 30 days from the date of this letter and must be signed by one of your principal officers. You may request a hearing with a member of the office of the Regional Director of Appeals when you file your appeal. If a hearing is requested, you will be contacted to arrange a date for it. The hearing may be held at the Regional Office, or, if you request, at any mutually convenient District Office. If you are to be represented by someone who is not one of your principal officers, he or she must file a proper power of attorney and otherwise qualify under our Conference and Practice Requirements as set forth in Section 601.502 of the Statement of Procedural Rules. See Treasury Department Circular No. 230.

[REDACTED]

If you do not protest this proposed determination in a timely manner, it will be considered by the Internal Revenue Service as a failure to exhaust available administrative remedies. Section 7428(b)(2) of the Internal Revenue Code provides in part that:

A declaratory judgment or decree under this section shall not be issued in any proceeding unless the Tax Court, the Claims Court, or the district court of the United States for the District of Columbia determines that the organization involved has exhausted administrative remedies available to it within the Internal Revenue Service.

If we do not hear from you within the time specified, this will become our final determination. In that event, appropriate State officials will be notified of this action in accordance with the provisions of section 6104(c) of the Code.

Sincerely yours,

[REDACTED]

District Director

Enclosures: 3

## ENCLOSURE

### Facts

Information submitted with your application indicates that you were incorporated on [REDACTED]. Your Articles of Incorporation state that you are organized to provide individuals and organizations with a central authority which will support, encourage, supplement, and coordinate the efforts of those presently engaged in constructive conservation of natural resources; to educate and inform the individuals through speaker bureaus, literature and films, educational programs and coordination; to advocate conservation of our natural resources; and to provide individuals with employment and job training skills.

Your application indicates that you are serving as an independent contractor to [REDACTED], a for profit organization. Under the current contract effective [REDACTED], you make initial home visits to low income and high usage households, make follow up home visits, outstate visits, and outreach activities. You receive \$[REDACTED] per initial home visits (1 1/2 to 2 hours), \$[REDACTED] per follow up home visit (45 minutes to 1 hour), \$[REDACTED] per out of state home visit (1 1/2 to 2 hours), and \$[REDACTED] per outreach call to customers that refuse participation or otherwise are not reachable.

During home visits, you try to educate those low income and high usage customers on how to save on their gas bills, how to read a gas bill, and leave them with free weatherstripping provided by [REDACTED] for self-installation. You design all educational materials and submit reports to [REDACTED] on the progress of those customers you visit. The list of customers is provided by [REDACTED].

Beginning [REDACTED], you began providing the same services for [REDACTED] as well. Contracts with both the [REDACTED] and [REDACTED] are projected to be your only source of income during the first three years of operation. The fees are priced to cover all operating expenses with an attempt to create a surplus ([REDACTED] % of total revenue for each of the first three years of operation).

These activities resulted from a broad mandate issued by the State Public Service Commission for utilities companies to promote energy conservation. In the case of [REDACTED], a three-year program was implemented in response to [REDACTED] and the Settlement Agreement in [REDACTED]. In this program, low income and high usage customers are targeted to receive specialized conservation services such as distribution of weatherization materials, the installation of high efficiency gas heating systems, and education on energy conservation. By providing the above specialized services, [REDACTED] is able to reduce the gas usage of these customers and the uncollectible accounts. Based on the mandate and Settlement Agreement, you submitted a proposal that you designed. You bid for and were awarded the contract.

When the application was submitted, [REDACTED], founder of this organization, was the sole officer on the Board of Directors. The organization subsequently added three more officers to the Board.

██████████'s resume indicates that from ██████████, he worked as program director and contract staff supervisor in the ██████████.

#### Law

Section 501(c)(3) of the Code provides, in part, for the exemption from Federal income tax of organizations organized and operated exclusively for charitable, religious, or educational purposes, no part of the net earnings of which inures to the benefit of any private shareholder or individual.

Section 1.501(c)(3)-1(a)(1) of the Regulations states that in order to qualify under section 501(c)(3) of the Code, an organization must be both organized and operated exclusively for one or more exempt purposes. If an organization fails to meet either the organizational or operational test, it is not exempt.

Section 1.501(c)(3)-1(c)(1) of the Regulations states that an organization will be regarded as "operated exclusively" for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3) of the Code. An organization will not be so regarded if more than an insubstantial part of activities is not in furtherance of of an exempt purpose.

Section 1.501(c)(3)-1(d)(1)(ii) of the Income Tax Regulations provides that an organization is not organized or operated exclusively for exempt purposes unless it serves a public rather than a private purpose.

#### Application of Law

In Rev. Rul. 68-373, it is held that a nonprofit organization primarily engaged in testing drugs for commercial pharmaceutical companies does not qualify for exemption under section 501(c)(3) of the Code. The testing is performed in order to comply with Food and Drug Administration requirements. Such testing is an activity ordinarily carried on as an incident to a pharmaceutical company's commercial operations and, therefore, serves the private interest of the manufacturer rather than public interest.

In Rev. Rul. 71-529, an organization is formed to aid organizations exempt under IRC 501(c)(3) by assisting them to manage more effectively their endowment or investment funds and charge only a nominal fee. Fees represent less than 15 percent of the total costs of operation. The revenue ruling concludes that the organization qualified for exemption under IRC 501(c)(3), and notes that the organization perform an essential function for charitable organizations. Also, by performing this function for a charge that is substantially below cost, the organization is performing a charitable activity.

In contrast to the above revenue ruling, Rev. Rul. 72-369 concerns an organization formed to provide managerial and consulting services for organizations exempt under IRC 501(c)(3). The organization enters into agreements with unrelated client organizations to furnish services on a cost basis. The revenue ruling holds that the organization does not qualify for exemption under IRC 501(c)(3) because providing managerial and consulting services on a regular basis for a fee is a trade or business ordinarily carried on for profit.

In B.S.W. Group, Inc. v. Commissioner, 70 T.C. 352 (1978), the Court upheld the Service's position that the organization does not qualify for exemption under IRC 501(c)(3). B.S.W. Group, Inc. is formed to provide consulting services in the area of health, housing, vocational skills, and cooperative management. All of B.S.W.'s clients are to be nonprofit (some of which may not be exempt). The services provided would be an alternative to full-time staffing of client organizations where budget considerations and lack of expertise would otherwise prevent such staffing.

The Court's opinion states that helping client organizations to seek a substitute for full-time staffing is not inherently charitable, scientific, or educational. Since voluntary contributions have neither been solicited nor received from the public, the organization's fees are set high enough to recoup all projected costs and produce a net profit. The Court stated that competition with commercial firms is strong evidence of the predominance of nonexempt commercial purposes. It is also noted by the Court that B.S.W.'s failure to limit its clientele to organizations which are themselves exempt under IRC 501(c)(3) is a negative factor.

The Court concluded by stating the following:

"....We are unable to find that petitioner's primary purpose is educational, scientific or charitable, the conduct of an ordinary commercial consulting enterprise in competition with other commercial firms."

#### Conclusion

You are primarily engaged in providing services that are ordinarily provided by commercial entities. The services you provide are those that are incidental or necessary for the operation of the for-profit organizations. You do not meet the requirement in Section 1.501(c)(3)-1(d)(1)(ii) of the Regulations because you operate for the benefit of private interests.

Your charges are priced to cover operating costs and still have a \$[REDACTED] surplus at the end of the first year of operation. As shown in Rev. Rul. 72-369, activities that are also performed by commercial entities are not transformed into charitable activities by being provided at cost, even if activities are performed for exempt organizations.

Whether the cost of operating is subsidized by contributions is a determinative factor. The organization described in Rev. Rul. 71-529 is deemed to satisfy the operational test of IRC 501(c)(3) because substantially all of the operating costs of its activities are to be subsidized by grants from independent charitable organizations.

Your organization, as a trade or business carried on without subsidization of the operating costs, is identical in all essential respects to the commercial activities of a for profit entity. Services are provided pursuant to strictly contractual obligations rather than any charitable obligations or educational purposes within the meaning of section 501(c)(3) of the Code. You do not meet the "operational test" of Regs 1.501(c)(3)-1(c).

Accordingly, you do not qualify for exemption under section 501(c)(3) of the Code because you do not meet requirements in sections 1.501(c)(3)-1(d)(1)(ii) and 1.501(c)(3)-1(c)(1) of the Regulations.